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First National City Bank
Monthly Letter
Business and Economic Conditions

New York, March, 1957

General Business Conditions

THE over-all measures of business activity have shown little change in February. The steel, automobile, and petroleum industries have maintained output at high rates and department store sales have been 5 per cent larger than in February last year, which, to be sure, was not a particularly good month. From all indications, general business indexes for the month will be about the same as in January, when nonfarm employment, retail sales, and nonresidential construction were all at record levels on a seasonally adjusted basis. Industrial production was the greatest for any January on record, although the moderate increase over December was not fully up to seasonal expectations. The Federal Reserve Board's index declined one point to 146 (1947-49 =100). February also usually brings a modest seasonal rise in output, after allowance for the shorter month. It remains to be seen whether this has been realized. In any event, it seems clear that general measures of activity have not slipped appreciably, if at all.

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While the statistical reports are good, however, it is common observation that business sentiment is less buoyant. Optimism has been tempered in recent weeks by a disposition to stress uncertainties and to express caution and misgivings. For some persons, the reason behind these doubts may lie no deeper than the sag in stock market prices. Thoughtful observers, however, are concerned with the significance of current soft spots and the potential weaknesses in an economy which has been running at top speed for a long time.

Inventory Buildup Slackening

The shift of sentiment is appearing in the commodity markets as well as in stocks. While wholesale prices and consumer prices – the cost of living – have risen to new record levels, prices of basic industrial materials on the average have been easing slightly for some time. Along with this go reports that purchasing agents in some cases are shortening commitments. Where this is so it reflects inventory accumulation, ability to obtain quick shipments, and a general feeling that inventories are a less attractive speculation than they were a few months ago. In the lighter steel lines, for example, fabricators' inventories have been replenished since the strike last summer; with shortages disappearing the inducement to build stocks further is disappearing also, despite the firm to strong outlook for prices. Copper and aluminum are two other metals in which markets are no longer tight. In some manufacturing lines also excessive inventories have appeared. Changes of this nature reduce the flow of orders to producers even though final consumption is maintained.

The other side of the matter, however, is that the trend of prices of manufactured goods continues upward, with corresponding inducement to cover needs. Orders for machinery and contracts for nonresidential construction rose in January, above both December and a year ago.

Contractual raises and escalator clauses in labor agreements will continue to boost wages for millions of workers throughout 1957 and touch off chain reactions in costs and prices. Construction costs in particular have been mounting steadily. In mid-February, Administration officials, stating that they wished to "avoid aggravating inflationary pressures by unnecessary competition for labor, materials, and equipment," halted the Government's lease-purchase plan for construction of 97 public buildings costing about $700 million and a $20 million post office building program.

Earlier, President Eisenhower had gone so far as to discuss the possible need for government control of prices and wages to prevent an upward spiral. It seems clear, however, that he was issuing a warning against excesses and pointing out to the country what might eventually be expected if inflationary pressures are long continued and tolerated, rather than suggesting the establishment of controls in the current situation. Forebodings of depression expressed by Secretary Humphrey and ex-President Hoover likewise were clearly not short-term forecasts, but warnings of the long-run effect of uncontrolled government expenditures, excessive taxation, and general lack of restraint.

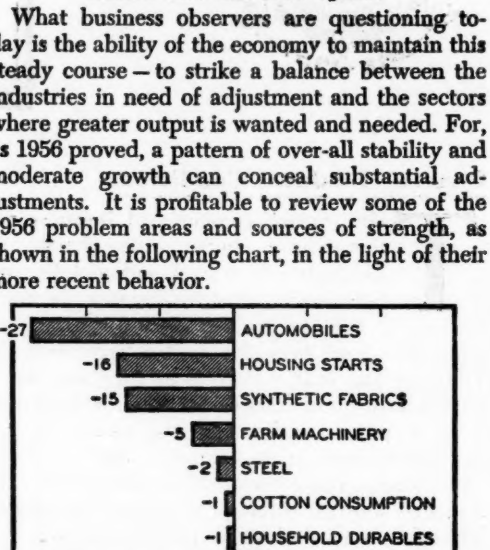
Business behavior at this time of year can readily create uncertainties. Each year, between the Christmas rush and the spring selling season, there is a letdown in many types of business activity — and often in business sentiment as well. This slackening is a regular seasonal occurrence, but it is not easy to determine whether the dip in any one year is greater or less than "normal" and by how much. Vagaries of the weather and the calendar — leap years and the shifting date of Easter — complicate interpretation of the data. Obviously, it is not the best time of year to form conclusions on whether business is changing directions.

Granting the obscurities and the existence of soft spots, the best information presently available indicates that basic demand from consumers, business, and government is strong enough to maintain high — although not necessarily record-breaking — over-all levels of output and sales through the months ahead. Unfilled orders in the manufacturing industries as a whole are holding at the peak, according to the latest figures, although no longer climbing. The flow of new orders is high, although in some lines it has declined. Government expenditures are rising.

As close as the economy is to its limits of skilled manpower, industrial facilities, and certain basic materials, a breathing spell of general stability should be welcome. If business levels off, it does not necessarily follow that it is poised on a crest facing a pronounced downward slope. Plateaus and irregular sideways movements of some length are common in business history.

Where Are the Soft Spots?

What business observers are questioning today is the ability of the economy to maintain this steady course — to strike a balance between the industries in need of adjustment and the sectors where greater output is wanted and needed. For, as 1956 proved, a pattern of over-all stability and moderate growth can conceal substantial adjustments. It is profitable to review some of the 1956 problem areas and sources of strength, as shown in the following chart, in the light of their more recent behavior.



The Rolling Adjustment in 1956
Percentage changes in physical output of selected industries, 1956 vs. 1955.

The concept of a rolling readjustment in which changes in various industries largely cancel out was probably never better illustrated than in 1956. The ability to offset sharp cuts in such important industries as auto production and homebuilding was convincing testimony of the basic strength of the economy. Latest reports show that a few of the 1956 soft spots have now disappeared, others are still with us, and some new ones have developed.

Two major industries whose output was down in 1956 are at present operating above year earlier rates. The principal dislocation in 1956 was in auto production, which weakened progressively throughout the first nine months. In

1957, passenger car manufacturers are maintaining a steady level of output throughout the first quarter, averaging about 6 per cent above the daily rate in the first three months of 1956, but below the extraordinary pace at the start of 1955. The prospect for 1957 sales cannot be fully appraised until the spring season arrives. Steel output, which last year averaged somewhat lower than the year before because of strike losses, has been running at a near-capacity annual rate of almost 130 million tons in January and February. Good judges think that some cutback in production of the lighter steels is to be expected before too long, but the shortages of structural steel, plates, and pipe can hardly be relieved during this year.

Housing has been a persistent soft spot. The number of new privately-financed homes started has been edging lower for over two years, and the 1956 total of 1,097,200 was one sixth below 1955's near-record 1,309,500. In January, the seasonally adjusted annual rate of new starts was 1,010,000 — not much lower than the closing months of 1956, but still about one sixth below a year earlier.

The more recent areas of weakness are consumer household durables, cotton consumption, and nonferrous metals, each of which showed little change on the average between 1955 and 1956. Latest data for each industry show production running 10 per cent or more behind last year. In each case the problem has been heavy inventories and resulting sluggish markets. Textile mills, appliance and television plants, and nonferrous metal processors have cut output in attempts to bring supplies into line, but to date they have been only partially successful.

Strong Points in the Economy

On the other hand, most industries which made a good showing in 1956 have continued strong. Output of electrical apparatus and industrial and commercial machinery was still rising at last reports, reflecting the capital goods boom. Obviously, however, as producers push output closer to practical capacity and demand levels off, the year-to-year gains narrow and the trend turns sideways. There is a loss of stimulus, but not of support. Aircraft factories have been stepping up their production at the rapid rate of nearly 3 per cent a month since mid-1956, largely because of government purchases of military aircraft and guided missiles.

There are other sources of support in the economy which could not be included in the chart for lack of a good measure of physical volume. The long-term increase in demand for consumer services shows no sign of tapering off. Private nonresidential construction and public works projects broke all records last year, but backlogs of proposed projects continue to mount. Engineering News-Record's tabulation of proposed heavy construction reached $104.2 billion at the end of 1956, 12 per cent greater than a year earlier and equivalent to nearly five years' work at the record 1956 rate. All told, with business and government committed to heavy expenditures, wage rates rising, and consumers spending freely for goods and services, it is hard to envision the current inventory adjustment in certain industries spreading into a general setback in the near future. Another rolling readjustment seems more probable.

Additional problems confronting the economy include the squeeze on profit margins and reduced corporate liquidity, possible changes in business plans for plant and equipment expenditures, and the ability of the steel and auto industries to maintain their present pace. It will be possible to get a much clearer view next month with the publication of special surveys on business plans for capital outlays and on consumer finances, attitudes, and buying plans. Within the next month or two the dimensions of the spring pick-up in consumer buying and home building will begin to take shape. Whether these reports reveal continued strength or bolster suspicions of weakness for the latter part of 1957, the course for the next few months appears much the same as at present — a generally high and steady level of activity.

Corporate Earnings in 1956

Corporate earnings for 1956 reported to date show an over-all total closely in line with that of 1955, reflecting business prosperity generally, the rebound from the third quarter industrial dip caused by the steel strike and auto model changes, and the continued enlargement of investment in plant and equipment. Our tabulation of the '56 statements of 2,550 companies gives a combined net income after taxes of approximately $16.1 billion, compared with $15.6 billion in 1955, an increase of 3 per cent. The number of companies with increases exceeded the number with decreases by about 3-to-1, the same ratio as a year ago. The small gain this year in dollar net income, however, contrasts with a gain of 26 per cent registered a year ago for 1955 over '54.

From the condensed preliminary summary given on the next page, it will be seen that a great majority of the major industrial groups show increases, but that the amounts of the increases are moderate in most cases.

Preliminary Summary of Net Income of Leading Corporations for the Years 1955 and 1956

(In Thousands of Dollars)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1955	1956	Per Cent Change
119	Food products	$ 420,279	$ 451,717	+ 7
37	Beverages	107,557	106,266	— 1
16	Tobacco products	162,285	172,225	+ 6
57	Textile products	118,816	125,374	+ 6
35	Clothing and apparel	24,718	27,881	+13
21	Shoes, leather, etc.	32,561	33,440	+ 3
22	Tires, rubber products	225,910	229,211	+ 1
33	Lumber, wood prod.	123,593	127,534	+ 3
55	Paper and allied prod.	340,684	372,110	+ 9
54	Chemical products	983,634	967,445	— 2
80	Drugs, soap, cosmetics	200,871	248,940	+24
17	Paint and varnish	90,996	107,683	+18
66	Petrol. prod. & ref.	1,980,495	2,237,347	+13
68	Cement, glass, stone	420,922	434,383	+ 3
43	Iron and steel	1,069,209	1,075,596	+ 1
456	Other metal products	1,805,039	2,008,005	+11
49	Automobiles & parts	1,917,966	1,274,649	—34
38	Other transp. equip.	212,614	217,577	+ 2
68	Misc. manufacturing	123,686	139,134	+12
1,284	Total manufacturing	10,361,835	10,356,517	—
15	Metal mining	75,953	78,316	+ 3
23	Other mining, quarry.	77,172	104,770	+36
38	Total mining, quarry.	153,125	183,086	+20
23	Chain stores — food	92,460	119,015	+29
38	Chains—variety, etc.	121,434	124,696	+ 3
49	Department & spec.	171,240	183,858	+ 7
41	Wholesale and misc.	245,766	270,315	+10
151	Total trade	630,900	697,884	+11
116	Class 1 railroads	915,000	874,000	— 4
43	Other transportation	88,868	112,490	+27
159	Total transportation	1,003,868	986,490	— 2
166	Elec. power, gas, etc.	1,205,490	1,315,045	+ 9
13	Telephone & telegraph	742,793	849,117	+14
179	Total public utility	1,948,283	2,164,162	+11
17	Amusements	28,574	28,150	— 1
24	Restaurant and hotel	19,520	29,339	+50
35	Other bus. ser. & const.	75,544	91,789	+22
76	Total amuse., ser., etc.	123,638	149,278	+21
373	Commercial banks	782,252	871,897	+11
182	Investment trusts	387,984	438,417	+13
65	Sales finance	182,795	205,985	+13
43	Real estate	10,052	11,821	+18
663	Total finance	1,363,083	1,528,120	+12
2,550	Grand total	$15,584,732	$16,065,537	+ 3

The public utilities supplying electric, gas, telephone, and other services continued their outstanding record of consistent long-term growth in both gross revenues and net income, supported by a record capital investment program. In the case of the railroads, however, a small increase in operating revenues was exceeded slightly by the increase in operating expenses including taxes, so that net income declined by 4 per cent. Railroad taxes rose to $1,121 million and took over 10 per cent of total revenues.

Many additional corporate reports to be issued during March will be included in a detailed summary in our April issue, which will show also the average rates of return on net assets and profit margins on sales. These are significant figures, in view of current indications and apprehensions of a "profit squeeze."

Mixed Trends in Industry

In the manufacturing industries, which are generally subject to sharper fluctuations than most other major divisions of business, reports of 1,284 companies show combined net income practically unchanged. Excluding the sharp decline in the automobile and parts group which reflected curtailed sales, manufacturing earnings rose 8 per cent. There were impressive gains by many leading producers of machinery and other capital equipment.

Quarterly figures available for a smaller number of manufacturers show net income in the fourth quarter of 1956 up 32 per cent from the third quarter, but 4 per cent below the relatively high fourth quarter of '55.

For the full year 1956, about 58 per cent of the reporting manufacturers had increases in both sales and earnings, many to all-time highs. In numerous cases gains in net were less proportionately than those in sales, indicating narrower profit margins. Some 7 per cent of the companies were able, despite smaller sales, to improve net income. Larger sales, but lower earnings, were experienced by 20 per cent, with smaller sales and earnings reported by the remaining 15 per cent.

The generally high earnings of 1956 reflected the benefits flowing from the record sums invested over the past few years for expanding and modernizing plant and equipment, lowering costs, and improving efficiency.

Many companies increased their earnings by introducing new products, devising new uses for old products, or penetrating new markets — reaping the benefits of heavy expenditures on research, both market and technical. Others profited by rounding out their sales lines through mergers, by diversifying into new fields, or by eliminating unprofitable items.

An almost universal complaint was the persistently rising tendency of costs. This hit particularly hard where sales slowed, or excess capacity prevented cost increases from being passed along fully in higher selling prices.

Many producers were hurt by the steel strike and resultant shortage of metal products. Others suffered from the curtailed pace of the auto industry and of residential building. The drought in some sections of the country hurt sales of farm implements.

In some cases earnings were cut by special charge-offs as unsatisfactory products were discontinued and plants closed down or sold. Other companies reported heavy start-up expense in connection with getting new plants into operation, from which they expected to reap later benefits. Earnings suffered when some manufacturers completed their defense contracts or had them scaled down.

Finally, corporate earnings were affected by various accounting practices. Accelerated depreciation of plant and equipment, especially facilities for defense production, resulted in lower net earnings last year, but should mean higher earnings in later years after the property cost has been fully depreciated. The LIFO or "last in-first out" method of inventory valuation served to reduce the overstatement of book earnings caused by price inflation.

Some statements contained special adjustments (debit or credit) in connection with capital gains and losses, income taxes, reserves, and the like, that affected current income as reported or were carried directly to surplus. Such accounting as well as economic factors all have a bearing on the indicated earnings and thus on the comparability of corporate reports — both as between different years and different companies.

Dividends Increased

Publicly reported cash dividend payments during the year rose 8 per cent in dollar total to set a new record, according to Department of Commerce computations. Increases occurred in all major categories of manufacturing, except transportation equipment, as well as in the fields of mining, trade, electric and gas utilities, communications, and finance, with railroads practically unchanged.

In numbers, also, the favorable dividend changes last year well exceeded the unfavorable, according to the tabulation by the New York *World Telegram & Sun.* Reflecting the pressure upon corporations for funds, however, dividends declared in the second half year were noticeably less generous than they had been a year earlier, as may be seen from the summary below:

Publicly Reported Cash Dividend Changes
By Half Years, 1955-56

	First Half		Second Half	
	1955	1956	1955	1956
Initial dividends	255	314	263	252
Resumed dividends	32	34	55	32
Increased dividends	430	477	581	432
Extra dividends	334	392	1,281	1,111
Reduced dividends	39	27	13	36
Omitted dividends	61	32	47	54

The figures given cover cash dividends only, and are exclusive of dividends paid in stock.

Debate on the Budget

The further increase in federal government expenditures, proposed by the President in his annual budget message in January, has precipitated widespread public debate. Indeed, the $72 billion fiscal '58 spending proposals have elicited perhaps more active controversy than any budget message since Mr. Truman's "Welfare State" budget submitted to Congress eight years ago and calling for spending $42 billion in fiscal '50.

In eight years a good deal of water has gone over the dam. Defense outlays alone have averaged almost $42 billion annually since the Korean War. "Welfare" and most other categories have swollen to new peaks, a good deal beyond Mr. Truman's aspirations for 1950. Tax rates — as he advocated — have been raised from the levels prevailing then. The public debt has risen from $252 to $276 billion. The dollar has lost one seventh of its 1950 buying power.

Leon Keyserling, who was Chairman of the President's Council of Economic Advisers during the last three years of the Truman Administration, assailed the new federal spending proposals as inadequate and this same point of view was expressed by spokesmen for organized labor. Director of the Budget Percival Brundage, who looks for still higher federal spending totals in the years ahead, disclosed that he was receiving many complaints over omissions of various projects. In a speech three months ago Mr. Brundage drew a picture of the vested interest built up in federal programs:

> . . . When I came down to Washington, I was strongly opposed to many of these programs and thought they should be drastically reduced. I have been surprised to see how very general the demand is for federal assistance, even from those very people who condemn it in principle. I am sure that we went too far in the direction of federal supports and control under the preceding Administration, but it's impossible to turn the clock back.

On February 4 the Budget Director told a meeting of the Citizens Committee for the Hoover Report that elimination of entire programs would be needed to make substantial cuts in federal spending. He went on to say:

> In spite of the tremendous criticism of spending which has appeared in the press, nine out of ten letters I receive still ask for something — for the National Guard, for the veterans, for dredging channels, for building dams, for the thousand-and-one programs in which our citizens are interested.

On the other hand, Congressmen were inclined to accept the view so vigorously and repeatedly expressed by Secretary of the Treasury Humphrey that outlays should be cut down. Reports were that Congressional mailboxes were full of complaints from home about the programmed rise in government expenditures and the absence of any tax reliefs. The business community was deeply disturbed by the implications of the spending proposals in terms of prospective inflation and taxation. Hints that price controls might have to be installed and taxes raised instead of lowered were even more start-

ling, emanating as they did from an Administration that three or four years ago cut expenditures and taxes, discarded controls, and promised more substantial tax cuts and more scope for individual enterprise.

Public Complaints

The National Association of Manufacturers expressed a common view when it stated: "Such gigantic spending, especially at a time when the economy is operating close to current capacity, seems sure to contribute to inflationary pressures." The U.S. Chamber of Commerce pointed out that the budget "shows little of the restraint it urges on the public." Roswell Magill, a former Undersecretary of the Treasury now President of the Tax Foundation, described the projected peacetime peak budget as "fantastic."

An Ohio woman wrote her Congressman that "if we need any controls, we need them right there in Washington." A woman from Massachusetts pointed out that "if a family – the people of this country – is asked to be more frugal, then it behooves the head of that family to set the example." A veteran of World War I wrote: "Mounting government spending is like a contagious disease which keeps spreading until the whole population is affected by its malign influence." A constituent from Connecticut wrote his Senator: "I feel there must be many people like myself who are unorganized and undemanding, except in our appeal to have the value of the dollar saved."

Chairman Cannon of the House Appropriations Committee said: "I have never seen the time when Congressional correspondence – from businessmen, labor, every segment of the population – was so uniformly demanding a reduction in spending. I think the Appropriations Committee is more disposed to cut this year than ever before." If the pressure of public opinion is sustained, we could have, as in 1945-48 and 1953-55, cutbacks in federal expenditures and taxes leading to a restabilization of the dollar. Objectives for cuts discussed in Congress ranged from $2 to $8 billion.

As Senator Byrd said:

> The President's budget is inflationary at a time when the country is facing a definite threat of inflation. It represents an increase in domestic spending of seven billion dollars over outlays in fiscal year 1954.
>
> The principal reason why the Eisenhower administration was able to stabilize the dollar in its first three years in office was because the President, with the help of Congress, cut nine billion dollars out of the budget Truman had proposed.
>
> We have certainly gone into a period of inflation now and the Eisenhower budget will increase that trend. It ought to be cut five billion dollars and I am going to try to show Congress how that could be accomplished.

Shock Effects

There is no question but that the $72 billion budget came as a considerable shock. For one thing, it strengthened fears of a chronically eroding dollar and even tighter money markets, and aroused apprehensions that the next step might be to set up bureaucracies to dictate prices and wages and ration credit. For another, it destroyed the hope that tax reliefs could be enacted for 1958 if not for 1957, and even raised the spectre of still higher taxes. Finally, thanks to the candor of Secretary Humphrey, it gave thinking people pause to wonder to what shape of fiscal crisis the rising curve of government expenditures is leading.

People were ill-prepared for the scheduled increase in federal expenditures, particularly against the background of the State of the Union message which, issued a week earlier, had so sharply focused attention on the dangers and inequities of inflation. Throughout history high and rising government expenditures have been the most common cause of price inflation.

The President's messages took satisfaction in the fact that the budget is balanced with a modest margin for debt retirement. But, from the behavior of prices, it is apparent that this is not enough. As Chairman Martin of the Federal Reserve Board pointed out to the Congressional Joint Economic Committee February 6, both the restraint on credit expansion and the federal surplus have been "a little bit deficient." Raymond J. Saulnier, new Chairman of the President's Council of Economic Advisers, also testified to the desirability of a larger surplus.

In the simplified arithmetic of compensatory fiscal theory, any level of government expenditures is supposed to be "deflationary" if it is more than covered by revenues; the government takes more money from the people than it pays out. But this is to overlook the public debt as well as all the human elements in the equation. People have an inclination to form judgments of what they can afford from their incomes before tax, and may borrow or sell assets as necessary to carry on the scale of living to which they feel entitled. Moreover, Savings bonds and maturing government securities give their holders a key to the Treasury cash boxes. Despite the current budget surplus, the Treasury has been having to borrow new money almost continuously to cover debt redemptions and keep a minimum working cash balance.

As Arthur F. Burns, former Chairman of the President's Council of Economic Advisers and now President of the National Bureau of Economic Research, pointed out two weeks ago:

> The real problem is that even a balanced budget can have inflationary effects. . . . Fiscal theorists recognize that when Government spending increases, and taxes increase to pay for it, people do not necessarily cut their consumption by the same amount as their tax increase. They may cut their savings so as to maintain, in part at least, their level of consumption.
>
> Thus the result of an added $100 of Government spending matched by a $100 tax increase may be $110 of demand on resources or stocks of goods. . . .

Dr. Burns also referred to the tendency of a tight money policy to curtail business expansion and investment, housing and school construction, but did not mention that high and rising government expenditures, and associated rising prices, are forces directly tightening the money market and soaking up resources otherwise available for business, home builders, and municipalities.

A "Do-it-yourself" Program

The third of the President's regular annual messages, the Economic Report, seemed to imply that there is no real scope for reducing federal expenditures below the budgeted levels and that the only ways the Government can repress rising prices is by higher taxes or a still more restrictive credit policy. These options in turn are rejected because taxes are already burdensome and credit unavailability is already seriously embarrassing many useful activities. Responsibilities for checking the rising price drift are passed on to individuals and economic groups — a sort of "do-it-yourself" anti-inflation program. Business managements and labor are supposed to "recognize the broad public interest" in setting their prices; in other words impose price and wage controls on themselves.

At hearings of the Congressional Joint Economic Committee economists almost universally warned that appeals to self-restraint would not work. It is hard enough to enforce price and wage controls backed by law in wartime emergency. To get price and wage stabilization by voluntary action in peacetime prosperity is a tall order indeed.

Secretary Humphrey testified that he thought the President's plea for labor-management restraint in wage and price policies would be observed to "some extent." Large business organizations do consider broad public interests, with most particular reference to paying good wages, producing good products, and pricing competitively. But, in an inflationary market no individual business is big enough or strong enough to resist long a trend of rising costs. Moreover, the economy is made up of myriad individuals and enterprises of all sizes and degrees of economic literacy. The one thing everyone understands is the need to keep up with the price-wage procession.

Trade union leaders give little encouragement to hopes for a wage stabilization. *U.S. News & World Report* on February 8 quotes one leader as commenting:

> Every time we get a pay raise for our members, the cost of living goes up. Then our members need more money to eat on. The Government is adding to inflation with its big budget and public debt. We'll have to have a little inflation to pay off the debt.

Among the rank and file the feeling may be a little different. According to *Business Week*, a member of the Oil, Chemical and Atomic Workers, which is seeking a 27 cents-an-hour raise this year, wrote his union:

> I believe that our demands sometime or other will bust the hell out of our union. Every time we get a raise in wages, Uncle Sam gets more and living costs go higher, so what or where are we gaining? Let's level off somewhere and try to go a few years in peace.

So we go around the vicious circle.

There is indeed only one unit in the economy that can make a critical difference in the price trend. That is the Federal Government. As Alfred C. Neal, President of the Committee for Economic Development, told the Congressional Joint Economic Committee on February 1:

> Control of inflation can never be primarily the job of private business or of private labor. Inflation cannot be controlled without controlling the money supply, and in a modern economy, government has that job.
>
> So, if we have inflation, let's not get confused about how it happened; it will happen because governmental authority was not used to turn off the money spigot or to reverse the money pump.

Tax Rates

Under the heading of Revenue Policy in his budget message the President asked for a continuation of corporate income and excise tax rates scheduled to decline this spring. He stated:

> It is my firm belief that tax rates are still too high and that we should look forward to further tax reductions as soon as they can be accomplished within a sound budget policy. Reductions in tax rates would give relief to taxpayers and would also release funds for the activity and investment necessary for sustained economic growth through private initiative. However, the reduction of tax rates must give way under present circumstances to the cost of meeting our urgent national responsibilities.

But are increased spending programs the exclusive formula for "meeting our urgent national responsibilities"? Is it not a national responsibility to regain a stable dollar? Is it not a national responsibility to "give relief to taxpayers" and "release funds for the activity and investment necessary for sustained economic growth through private initiative"?

Over the last few years there has been a widening public dissatisfaction with the federal tax structure. The Congressional Joint Economic Committee undertook a considerable study in 1955, looking forward to federal tax reductions. The rising levels of State and local taxes have made people more conscious of the aggregate weight of taxes which is now closely approaching $2000 a family. Corporate taxes are a severe burden on business growth and a major item in the high price level. The base of the personal income tax has been eroded by more and more special exemptions, deductions and allowances, increasing the inequities of the steeply progressive rates to persons without access to loopholes. Thus we have a weakening of the morale of the taxpayer, of respect for the law, and of the integrity of the fiscal system.

People had been led to expect federal income tax reductions. Such reductions were promised as the next step when the Revenue Act of 1954 was passed. The balanced budget a year ago raised hopes of cuts effective this year. Both party platforms in the recent election called for tax cuts. The optimism of the business community in viewing the market opportunities of the future has been supported by expectations of tax relief for themselves and their customers. Instead we have a budget message that not only removes hopes of a 1957 tax cut but has nothing to promise but continuously rising federal expenditures.

Trouble Ahead?

At hearings of the Economic Committee on February 6, Frazar B. Wilde, Chairman of the Research and Policy Committee of the CED, commented on the rather common view that, after all, a slow rate of inflation is a small price to pay for full employment. More and more people are saying that nothing can arrest the rise of prices and government expenditures so that we might as well relax and enjoy it, find capital gains and ways around the income tax and take satisfaction in the growth of nominal income and wealth.

This is a fool's paradise. As we have discovered, inflation brings shortage of credit, and speculative ventures are apt to be the first ones hit. With prices and wages rising, business runs short on cash despite good profits. The progressive income tax structure appropriates a larger and larger percentage of the national income into government hands. The unequal distribution of the costs of inflation brings social discontent. Utilities have trouble raising their rates. Retired people on fixed incomes get hurt. Banks are criticized for raising interest charges. Demands arise for price controls, government intervention, and destruction of individual freedoms and opportunities.

The history of great booms is that they inevitably collapse. The history of inflation is that, in the absence of firm restraints, it tends to accelerate.

Pointing out that a 2 or 3 per cent inflation in one year is a rate that would double the price level in between 23 and 35 years, Mr. Wilde said:

> There is no assurance that a small rate of inflation, once tolerated and accepted by public policy and private thinking, will remain small. On the contrary, there is every reason to believe that under such conditions the rate of inflation would accelerate. There may have been times in the past when slow inflation could go on for a long period unobserved by the population at large.
>
> This is no longer true in the United States. The sight of a continuous even though slow trend of inflation will set in motion efforts on the part of all groups of the economy to protect themselves against it – to make wage rates rise faster and to adjust all kinds of contracts to the estimated future higher level of prices. The consequence of this effort of each to protect himself against the anticipated rates of inflation can only be a still greater rate of inflation.
>
> We must conclude that inflation is an intolerable, unacceptable and unsustainable way of life and will ultimately lead to full unemployment.

Once under way it is hard to stop an accelerating rise of public expenditures and prices. The new rise – only a year old – is young. It is within control by prompt and energetic action on the budget. We have not reached a point where nothing but a drastic shakeout can restore stability. The economic outlook for the next eighteen months is good, as Secretary Humphrey has testified. But, as the Secretary also has pointed out, we are embarked on a path that may lead ultimately to disaster.

It is no reassurance that so many experts say it cannot happen, that government cannot let it happen. The worst readjustments are those that couldn't happen. Way back in 1925 ex-President Hoover warned the Federal Reserve Board of the perils in an easy money policy:

> As to the effects of these Reserve policies upon the United States, it means inflation with inevitable collapse which will bring the greatest calamities upon our farmers, our workers and legitimate business.

Instead of being concerned about a depression, people grew cocky and careless, confident in the assumption that the Federal Reserve could control the business cycle. It is ironic that Mr. Hoover himself fell victim to the onslaught when it came in 1929.

Many people take comfort in the fact that conditions in the 1920's and now are so different. The

point of similarity is a growth of confidence in government's power to forestall depressions. Then government expenditures were held in check, and commodity prices were steady, but credit policy was too lenient and indulgent of the boom. Now, credit policy is more effectively restrictive but government expenditures are growing out of hand.

Responsibilities of Government

The President's Economic Report, while laying the primary stress on the responsibilities of individuals and economic groups, gives an eloquent statement of the responsibilities of Government:

> Government must use all practicable means to promote high levels of production and employment, and to contribute toward achieving an expanding and widely-shared national income, earned in dollars of stable buying power. It must pursue policies that encourage the enterprising spirit of our people and protect incentives to work, to save, and to invest. It must exercise a strict discipline over its expenditures and avoid taking in taxes too much of the incomes of individuals and businesses. It must strive to strengthen competitive markets and to facilitate the adjustments necessary in a dynamic economy.

These responsibilities need only to be implemented, by exercising a really "strict discipline" over government expenditures, restabilizing the dollar, and easing the taxes to "encourage the enterprising spirit of our people and protect incentives to work, to save, and to invest." Under an unreformed tax structure the Government proposes to take bigger and bigger slices of the incomes of individuals and businesses. It is a perilous experiment, as the United Kingdom discovered, to see how much taxation a rich and productive economy can stand.

The Wage-Profit-Price Controversy

During the past few months the American people have been indulging in one of their periodic debates over which is more responsible for rising prices — management or labor. This argument always crops up during periods of upward price pressures, and rumblings of a renewal of this old controversy have been in evidence for some time. It flared into the open with President Eisenhower's appeal to both management and labor for restraint in negotiating new wage contracts.

The reaction to these statements by the President has been spirited and partisan.

Management blames rising prices upon rising costs, particularly wage increases which it contends have often exceeded gains in productivity. It points to narrower profit margins as refuting the charge of profiteering and as evidence of an increasing cost-price squeeze.

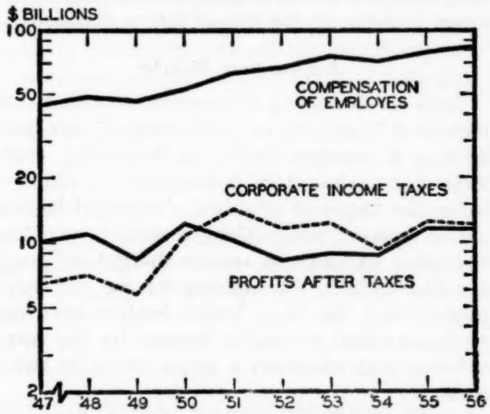
Labor retorts that price increases are not due to wages, but to "unwarranted" attempts by industry "to fatten profit margins." Spokesmen for labor present data purporting to show that profits have risen faster than wages, making possible wage increases out of profits without raising prices. The AFL-CIO executive council, meeting at Miami Beach last month, demanded a Congressional investigation of price-profit-investment-wage policies of major corporations. One labor economist testifying at a panel session of the Joint Congressional Economic Committee, went so far as to propose a statute requiring such corporations to report and justify planned price increases to the Government before putting them into effect.

A Look at the Record

All this is an old story.

One of the difficulties in comparing wage and profit increases is in selecting the base period. Almost any relationship can be shown, depending upon the base chosen.

Another difficulty is in determining the companies or groups for comparison. Because of the variety of profit and wage patterns among the different companies and industries, there is the problem of finding patterns that can be regarded as typical.



Wages, Profits, and Taxes in Manufacturing
(Source: U.S. Department of Commerce, 1956 partly estimated.)

A simple over-all picture is the trend in the period 1947-56 of compensation of employes (including fringe benefits), profits, and taxes in the manufacturing industries, as computed by the U.S. Department of Commerce in

its national income series. This is shown in the preceding chart, from which the reader can select his own base. Figures are given for the manufacturing industries rather than for all corporations because, by and large, it is in this area that the most dynamic changes have been occurring.

It is clear from the chart where, as between the employes, the U.S. Treasury, and the shareholders — the major gains have gone.

By far the largest share has gone to employes in the form of higher compensation. This soared from $44½ billion in 1947 to more than $83 billion in '56 — nearly double.

Government took the next biggest bite in the form of income and excess profits taxes. These rose from $6½ billion in '47 to over $12 billion in '56 — likewise nearly double.

By contrast, profits after tax — what remained to the shareholders for the use and risk of their money — have fluctuated around the same dollar levels, meaning a smaller share of the manufacturing industry turnover.

The totals of employe compensation reflect an increased number of workers as well as higher wage, salary, and benefit rates. Average annual earnings per full-time employe rose from $2,800 in 1947 to $4,600 in 1956 or by 63 per cent. The profit figures, on the other hand, show little reflection of the billions of dollars of new capital poured into these industries over the period. In fact, when allowance is made for this huge additional investment, the rate of return declined.

A Constant Battle

From the foregoing it is evident that industry, instead of "fattening its profit margins" has been fighting a constant battle against rising costs. Nevertheless, industrial pricing policies continue to be the target of criticism. Industrial leaders are being haled before Congressional committees and other tribunals to answer charges of "gouging the public," "conspiring to fix and raise prices," and the like. Union leaders have not yet been called to similar account for the wage inflation that has been a major factor in rising costs.

The President's statements reflect an understandable neutrality in dealing with these controversial matters. But he pointed out in his Economic Report that high costs of raw materials and wage increases that "tended to outrun last year's small gain in productivity" were "pervasive factors" making for higher prices. Secretary of Agriculture Benson, in a speech at Spokane, Washington, denounced with characteristic candor "soft wage settlements" as responsible for higher prices and for most of the drop in farm income.

Moral Suasion Not Enough

The President's plea for self-restraint on the part of management and labor is appropriate and timely. The trouble is that, as pointed out in the recent report of the Joint Congressional Economic Committee, this plea conflicts with the financial incentives of both parties.

The AFL-CIO executive council, at its Miami meeting, served notice that labor unions intended to keep asking for wage increases based on the "productivity and profitability" of industry — applying, no doubt, their own yardstick on those two crucial points. With new wage contracts to be negotiated this year in the petroleum, rubber, chemical, textile, and paper industries, — to mention a few — it is hard to believe that the unions involved will be satisfied with anything less than the automatic pay boosts scheduled for some five million other workers under long-term agreements signed in the past two years.

Labor leaders feel it is their job to try to increase workers' wages and other benefits as much as possible. They face competition within their own organizations, and their effectiveness as leaders is judged by how much they can get for their "constituents," not only in relation to past gains but also in matching the achievements of other unions.

Industrialists are equally positive on the need for higher prices to compensate for higher costs. Suggestions that the companies "hold the line" on prices by absorbing higher wage costs overlook the obligation of management to the shareholders who employ their services. How long could management, neglecting this obligation, remain in office? Can organized labor rightfully claim the lion's share, and more, of increased productivity at the expense of the entrepreneur and the general public? What will such a policy do to the pace of industrial growth and development counted on to create more and more jobs and to better living standards generally?

Criticism of management for not being more resistant to wage agreements that raise prices ignores the realities. Disregarded are the almost certain consequences of long and costly strikes, damaging not only to the companies directly concerned but also, where major industries are involved, to the community and even to the nation. Where management has tried to make a

stand it has often found itself under pressure from the public and government for a "quick settlement."

"Concentrations of Power"

The President, in his Economic Report, referred to "concentrations of power" making it possible for leaders of business and labor to take actions "significantly affecting" the Nation as a whole. However it may have been in times past, there is no question where this term is most applicable today. Despite the talk of "giant industrial monopolies," the fact is that the ability of industry to exert any concerted power of the kind implied falls far short of that now wielded by the great labor combinations.

What industrial "concentrations of power" can arbitrarily shut down and paralyze whole major industries, as labor has done again and again? Even the biggest industrial enterprises find themselves under the constant restraints of the competitive market, requiring the offering of goods and services of a kind and at prices that will win acceptance by the final arbiter — the public. The entering into agreements to fix prices or otherwise temper the rigors of competition is denied to industry by the anti-trust laws.

Not so with the labor unions. Exempt from the jurisdiction of anti-monopoly and anti-trust legislation, they are free to enter into nation-wide combinations for the purpose of fixing prices and conditions of labor that all business, large and small, must meet. Their monopoly power is strengthened in many cases by restrictions on the number of apprentices admitted to membership each year, and — wherever possible — by insistence upon closed shop agreements that make union membership a condition of the right to a job.

This tight hold on the labor supply and national wage scales is something to which even "big business" can offer very little opposition. Where such concentration of power exists, its very existence imposes upon those who possess it the responsibility to use it moderately. Its use to impose wage settlements involving regular wage increases, year after year, in excess of gains in productivity, keeps the wage-price spiral turning. The consequences are harmful to everyone. The continued insistence by organized labor upon monopoly power makes fitting the quotation of the following advice by one of its best friends, the late Supreme Court Justice Brandeis. In his book entitled *Business — A Profession*, published in 1914, he said:

> This practical immunity of unions from legal liability is deemed by many labor leaders a great advantage. To me it appears to be just the reverse. It tends to make officers and members reckless and lawless, and thereby to alienate public sympathy and bring failure upon their efforts. It creates on the part of employers also a bitter antagonism, not so much on account of lawless acts as from a deeprooted sense of injustice, arising from the feeling that while the employer is subject to law, the union holds a position of legal irresponsibility. . . .
>
> The unions should take the position squarely that they are amenable to law, prepared to take the consequences if they transgress, and thus show that they are in full sympathy with the spirit of our people, whose political system rests upon the proposition that this is a government of law, and not of men.

The Role of Government

What all this points up is the major role that government must play if inflation is to be contained. Government is responsible, not to any one group, but to all the people — the shareholder, the worker, the consumer, the retired person living on a fixed income or savings.

To hold inflationary forces in check, government must be prepared, as emphasized earlier, to adopt appropriate budget and credit policies. This means holding back on its own spending to avoid competing in the markets for scarce goods and services, setting an example of frugality. It means initiating policies of credit restraint calculated to discourage unnecessary borrowing and to encourage people to save more and to pay their debts.

Such actions are seldom popular, for some people are bound to find themselves squeezed or deprived of expected gains. Also, they involve risk of the brakes being applied too hard. Yet they are unavoidable if greater danger is to be averted, and an answer found to the problem of maintaining stable prices during full employment. How the people measure up to this test will be proof of their maturity and capacity for intelligent management of their affairs.

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